

THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE

JULY 2004

OVERVIEW

- In the first quarter of 2004 real gross domestic product (GDP) grew 2.4% following an increase of 3.3% in the fourth quarter of 2003.
- Final domestic demand climbed 4.8%, up from 2.3% in the previous quarter. Consumer spending increased a robust 5.5%, residential investment jumped 14.4%, and business non-residential investment rose 2.1%. Real exports increased 6.3%, as strong U.S. growth over the last three quarters boosted demand for Canadian products.
- Much of the increased domestic and foreign final demand was met from inventories. Inventory accumulation dropped to \$1.0 billion in the first quarter from \$12.2 billion in the fourth quarter.
- The current account surplus rose \$11.3 billion to \$38.0 billion, or 3.0% of nominal GDP, the 19th consecutive quarterly surplus.
- The Canadian economy created over 110,000 net new jobs in the first six months of 2004. The unemployment rate was 7.3% in June, up slightly from 7.2% in May.

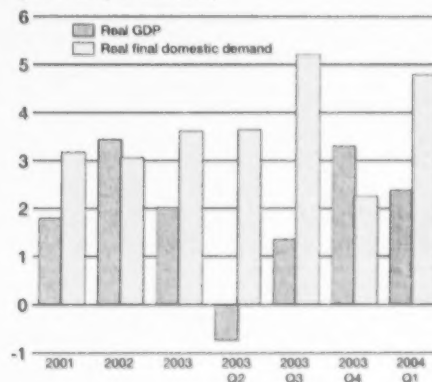
Real GDP growth continues

Real GDP rose 2.4% in the first quarter following a 3.3% fourth-quarter gain, as final domestic demand and exports grew while inventory investment slowed (Chart 1).

Consumer spending jumps

Real consumer expenditure grew 5.5% in the first quarter following minimal growth in the fourth. The increase was broadly based, with robust gains in durables and semi-durables. Spending on automotive products increased despite declining passenger car unit sales, as purchases shifted to higher-priced vehicles.

Chart 1
Growth in real GDP
and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, July 9, 2004.



Department of Finance
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Main economic indicators

(per cent change at annual rates unless otherwise indicated)

	2002	2003	2003:Q3	2003:Q4	2004:Q1	Most recent	
Real gross domestic product	3.4	2.0	1.4	3.3	2.4	—	
Final domestic demand	3.1	3.6	5.2	2.3	4.8	—	
Government expenditure						—	
Goods and services	2.8	3.8	0.4	3.9	1.1	—	
Gross fixed capital	9.1	6.8	1.0	5.9	7.9	—	
Consumer expenditure	3.4	3.1	4.4	0.7	5.5	—	
Residential investment	14.5	7.5	19.7	8.6	14.4	—	
Business fixed investment	-4.0	3.2	12.3	3.3	2.1	—	
Non-residential construction	-8.3	1.0	4.0	3.5	-4.4	—	
Machinery and equipment	-1.2	4.5	17.8	3.2	6.5	—	
Business inventory investment (\$ billion)	2.1	11.9	3.4	12.2	1.0	—	
Exports	1.1	-2.4	-1.9	9.4	6.3	—	
Imports	1.4	3.8	-3.0	17.8	0.5	—	
Current account balance							
(nominal \$ billion)	22.7	23.8	26.5	26.6	38.0	—	
(percentage of GDP)	2.0	2.0	2.2	2.2	3.0	—	
Nominal personal income	2.7	3.0	3.2	2.7	3.9	—	
Nominal personal disposable income	3.8	3.0	0.9	2.8	4.3	—	
Real personal disposable income	1.7	1.4	-0.8	3.1	2.2	—	
Profits before taxes	8.6	10.0	20.3	14.6	26.6	—	
Costs and prices (% , y/y)							
GDP price deflator	1.0	3.2	3.0	2.2	1.7	—	
Consumer price index	2.2	2.8	2.1	1.7	0.9	2.5	May-2004
CPI excluding eight most volatile items	2.4	2.2	1.7	1.9	1.3	1.5	May-2004
Unit labour costs	0.5	1.5	1.8	1.2	1.2		
Wage settlements (total)	2.8	2.6	3.1	2.0	2.7	2.3	Apr-2004
Labour market							
Unemployment rate (%)	7.7	7.6	7.9	7.5	7.4	7.3	Jun-2004
Employment growth	2.2	2.2	0.8	3.6	1.1	1.9	Jun-2004
Financial markets (average)							
Exchange rate (cents U.S.)	63.7	71.6	72.5	76.0	75.9	75.95	08-Jul-04
Prime interest rate (%)	4.2	4.7	4.7	4.5	4.2	3.75	08-Jul-04

Note: Real values are in chained 1997 dollars.

Sources: Statistics Canada, the Bank of Canada and Human Resources and Skills Development Canada.

While employment growth was modest, higher compensation per employee boosted labour income 3.4% and personal income 3.9% in the first quarter. Real personal disposable income rose 2.2% while real personal disposable income per capita rose 1.8%. The personal savings rate dropped to 0.5% from 1.3% in the fourth quarter.

Residential investment growth strong

Low interest rates continued to support the housing market, as residential investment increased a robust 14.4% in the first quarter. New construction activity jumped, as housing starts remained at a high level. Renovations also grew solidly while existing house resales and real estate transfer costs rebounded from drops in the fourth quarter.

Business fixed investment rises

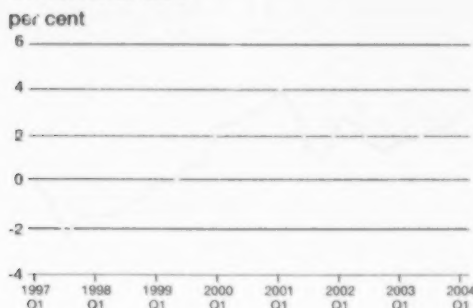
While growth in business spending on plant and equipment rose for the fifth consecutive quarter, the pace of growth slipped to 2.1% in the first quarter from 3.3% in the fourth. Investment in machinery and equipment rose a more robust 6.5%, double the 3.2% gain in the fourth quarter. While spending on car fleets dipped, it jumped for trucks and other transportation equipment. Investment in information and communications technology continued to rebound from previous depressed levels. Spending on software rose while that on telecommunications equipment soared 25.9%. Investment in computers and other office equipment dipped.

Non-residential construction fell 4.4% after a gain of 3.5% in the fourth quarter. Spending on building construction, such as office towers and shopping malls, dropped sharply for a second consecutive quarter while that on engineering projects decreased following a sharp gain in the fourth quarter.

Businesses add less to inventories

Businesses boosted inventories \$1.0 billion in the first quarter, down sharply from the fourth-quarter accumulation of \$12.2 billion. With strong sales, retail inventories dropped, especially those of motor vehicles. The manufacturing, mining and utilities industries also lowered inventories, while farm inventories increased.

Chart 2
Current account as a percentage of nominal GDP



Exports continue to rebound

Real exports rose 6.3% after a sharp fourth-quarter gain that followed four consecutive declines. Strong foreign demand raised exports of industrial goods and materials, energy products, and especially machinery and equipment. However, exports of automotive products slipped, as U.S. motor vehicle sales fell.

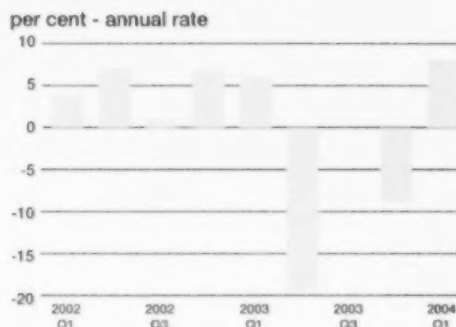
Imports flatten

Real imports edged up 0.5%. Imports of machinery and equipment and industrial products rose while imports of automotive products, other consumer goods and forest and energy products fell.

Current account surplus widens

In the first quarter the current account registered its 19th consecutive surplus, in contrast with deficits throughout most of the 1980s and 1990s. The surplus rose \$11.3 billion to \$38.0 billion, or 3.0% of nominal GDP (Chart 2). Higher export prices (Chart 3), especially for energy products, added to the positive impact of real trade movements, improving the goods trade surplus by \$13.7 billion. A \$1.9-billion deterioration in the investment income deficit, as dividends and retained earnings from Canadian direct investments abroad fell, partly offset that gain.

Chart 3
Change in export prices



Inflation remains low

The GDP deflator, a comprehensive measure of domestic prices, increased 4.8% in the first quarter following a 1.4% increase in the fourth, as rising energy prices boosted export prices. The GDP deflator stood 1.7% higher than a year earlier.

Year-over-year consumer price inflation rose to 2.5% in May from 1.6% in April and 0.7% in February and March as energy prices jumped. However, inflation remains well below the recent high of 4.6% in February 2003. At 1.5% in May, core CPI inflation, which excludes the eight most volatile items, sat below the 2% target, the mid-point in the official 1% to 3% band.

Corporate profits jump

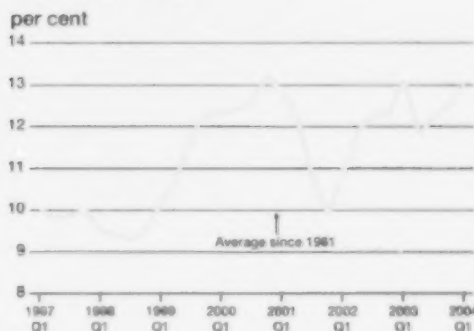
Corporate profits rose 26.6% in the first quarter, following a 14.6% jump in the fourth quarter. Profits of the oil and gas, manufacturing, and public utilities industries showed significant gains. Three consecutive double-digit increases have raised corporate profits as a share of GDP to 13.0%, well above the 10.0% historical average (Chart 4).

Employment grows

Employment grew 1.1% in the first quarter and 2.0% in the second. In the first six months of 2004 the Canadian economy created 110,800 net new jobs. The participation rate sat at 67.5% in June, slightly below its record high of 67.7% set in December 2003. The unemployment rate sat at 7.3% in June, up slightly from 7.2% in May.

Hourly labour productivity increased 0.3%, as output rose more than hours worked. Labour costs per unit of output climbed 1.0% to stand 1.2% higher than a year earlier.

Chart 4
Profits before taxes as a share of nominal GDP



Bank of Canada holds its policy rate unchanged

On June 8 the Bank of Canada left its key policy rate—the target for the overnight rate—unchanged at 2 per cent after having lowered it by 25 basis points on April 13. The Bank decided on this course since it now projects “that the economy will return close to its production potential by the third quarter of 2005 and that core inflation will move back to the 2 per cent target by the end of 2005.”

The U.S. Federal Reserve raised its discount rate by one-quarter of one percentage point on June 30. The gap between short rates in the two countries has narrowed since early in 2004. Long-term rates have risen less in Canada than in the United States, reducing the spread in the two countries’ long rates.

The Canadian dollar closed at 75.95 cents U.S. on July 8, off the 78.67 cents U.S. level of January 9, which was its highest closing value in over 10 years.

